

# The Weekly Focus

A market and economic update

23 August 2010



# Contents

Newsflash .....	3
Market Comment .....	3
Economic Update .....	5
South Africa .....	6
United States.....	7
Weekly Market Analysis.....	9
Rates .....	10
Standard Bank Money Market Fund .....	10
STANLIB Cash Plus Fund .....	10
STANLIB Dividend Income Fund .....	10
Glossary of terminology .....	12

# Newsflash

While many governments are up to their eyeballs in debt, companies in most parts of the world are flush with cash

## Market Comment

- BCA Research notes that recessions following housing and credit busts (as occurred in the US) tend to be deep and long, and are followed by lackluster (although sustained) recoveries.
- They say that US economic growth and consumer spending have followed the “script” of past similar recoveries so far, as have equity and bond markets. So they expect the recovery to be bumpy with periodic growth scares along the way, although recent weakness in the US job market is worrying.
- A rise in the unemployment rate in the US would be politically painful for the US congress, especially for the Democrats that appear headed for significant losses in the November mid-term elections.
- Stock markets jumped smartly in July, but have given up about half of that gain as weaker economic news has filtered through, especially from the US and Japan (Europe has been better, with Germany a star). STANLIB has raised its estimated probability of a double-dip recession from 30% to 35% as a result, partly because of the weaker jobless claims number in the US and its potential effect on consumer spending.
- The US S&P 500 Index is down around 5% since early August. US analyst, Elaine Garzarelli, expects corrections to be limited to 5-7%, based on her quantitative system. She says the index is about 13% below its fair value.
- Bank of America Merrill Lynch expects the S&P 500 Index to perform better than the US economy because of its substantial exposure to countries outside the US.
- They note that 40% of S&P 500 Index profits come from outside the US (25% from developed economies and 15% from emerging economies). This is double the 20% of fifteen years ago. Also, about two-thirds of the 40% foreign exposure is from global cyclical sectors (technology, materials/mining, energy and industrials). These global cyclical sectors now contribute about 45% of S&P 500 earnings, up from 35% fifteen years ago.
- Merrills believe, interestingly, that the importance of the US consumer is overstated, saying that although 70% of the US economy comes from household consumption, only 30% of US GDP is US retail spending and only 15% of S&P 500 profits are from global consumer discretionary spending. They believe that business spending is more important for the S&P 500 Index than consumer spending, with 20-25% of profits coming from business spending. Also, another 15-20% of profits come from commodity producers, so high commodity prices are positive for the S&P 500 Index.

- In their view, the S&P 500 Index is trading at 1970 (very low) price-to-earnings ratios, despite 1930 (very low) interest rates.
- Merrills note, too, that the broadening of China's economy to include more urban household consumption will benefit many leading US and European multinational companies. As they put it, China was export driven, now its construction driven; it will slowly become consumer driven.
- They also note that 70% of global growth in 2011 is expected to come from emerging markets and only 30% from developed markets. The Asian developing economies are now the same size as the US economy.
- Some other interesting facts from Merrills research: over the last 5 years, the six emerging economies of China, Brazil, Russia, Indonesia, Taiwan and Egypt have added 30 jobs for every one US and European job. Over the last two years (2008/9), the same six emerging economies added 10 million jobs, while the US and Europe lost 11 million jobs.
- Combined Emerging Asia and Latin America household consumption, which is about 50% of their GDP (economies), equals US household consumption, which is 70% of the US economy (GDP) and is bigger than European household consumption.
- While many governments are up to their eyeballs in debt, companies in most parts of the world are flush with cash. For example, in the US corporate cash flow as a percentage of the US economy at 10.5% is still near record high levels. Cash holdings are the highest in 50 years at 7% of all assets.
- So it is not surprising to see plenty of deals hitting the market of late: Billiton bidding for the world's biggest fertilizer company, Potash, SAB Miller bidding for Fosters in Australia, HSBC keen to buy up to 70% of Nedcor (largely from Old Mutual) and many others. These are all positive signs for the stock market (companies are clearly seeing value there) as we enter the final stage of the long-drawn and languid northern hemisphere summer months.

**Paul Hansen**

**(Director: Group Advisory Services - Investments)**

# Economic Update

Last week South Africa recorded some improved economic data. SA retail sales jumped to a growth rate of 7.4%/y, which is the strongest annual growth rate since early 2007. The strong pick-up was helped by the world cup. This implies that retail data for July will also be fairly robust, although the boost from sales of TV sets was probably more evident in May and June and far less significant in July. It is then likely that retail activity in August to October will appear to go 'soft' relative to the base that is currently being established. Latest retail sales data together with better than expected manufacturing data will provide a welcome boost to Q2 2010 GDP.

SA residential building plans appear to be passed the worst, with very tentative signs of improvement. In contrast, commercial property development is still trending lower.

Internationally the recovery is more erratic, US headline retail sales improved in July, but the improvement was a little less than market expectation; and if vehicle and gasoline sales are excluded, retail sales actually declined. US retail sales are still, effectively, struggling to gain any meaningful traction; but not necessarily slipping back into recession.

US housing starts rose modestly in July, but building permits plunged by a further 3.1%/m, more than expected. Building permits are almost back to their record low. US housing activity is not showing clear signs of recovery. A range of housing indicators are now at, or near, record lows. These include new homes sales, housing permits, housing starts and mortgage applications for purchase. More positively, although the housing market is probably the single weakest aspect of the US economy, there are some supportive factors (including the affordability index and the most recent evidence of stability in house prices), which suggest that the housing market is unlikely to cause the US economy to move back into recession (but equally not lead the economic recovery).

US leading economic indicator rose fractionally in July, in-line with expectations. Leading indicator has risen in 11 of the last 12 months, but the momentum has slowed noticeably. The Conference Board's Leading Indicator has a reasonable track record in forecasting GDP growth by up to one year however, the most recent moderation in the annual rate of change suggests that the US economic recovery will lose momentum into 2011 (but avoid a double-dip recession).

US weekly jobless claims spiked to 500 000 last week, highest level since mid-November 2009. Jobless claims have risen for three weeks in a row. It is hard to avoid the obvious and very worrying conclusion that there is something happening to accelerate the pace of US job losses!

## South Africa

### SA Retail Sales

- On an annual basis retail sales are now up 7.4%/y
- In the three months to June 2010 (Q2 2010), retail sales were up a very encouraging 1.2%q/q, seasonally adjusted (but not annualised), highlighting that the SA consumer spending has slowly started to improve, albeit boosted by the world cup.
- Most categories of consumer spending appear to be on the mend. There was a very noticeable further surge in sales of appliances in June (possibly TV's etc ahead of the soccer World Cup), continued strong sales in cosmetics and pharmaceutical goods as well as clothing. A key area of sustained weakness is undoubtedly spending on hardware, paint and glass, which has been struggling for the last year off a high base of activity that was established in the period from 2004 to early 2008.
- While consumers remain under pressure, there is a sense/expectation that the pressure will systematically ease during the course of 2010/2011. This expectation is based on the current low interest rate environment being sustained for all of 2010 and much of 2011, a further moderation in inflation (at least in the short-term), wage increases that are now rising above inflation (leading to a real increase in consumer income) and less job losses as domestic and world growth improves. Additionally, there has been a more positive wealth effect this year, with house prices moving firmly higher. Growth in consumer bank credit also seems to be improving, albeit very slowly.

### SA Building Statistics

- Overall building plans passed were up 0.9%q/q in Q2 2009, which compares with a decline of 5.9%q/q in Q1 2010. In the first half of 2010, building plans passed remain 14.3% below the level in the first half of 2009.
- In Q2 2010, residential building plans passed rose by a very encouraging 7.8%q/q, which is in contrast with a further 1.7%q/q decline in commercial building development. In the first half of 2010, commercial property development is down a massive 35.3%/y, while residential building plans passed are only down 5.0%/y.
- For example, while commercial property rentals are under pressure (especially office space) and vacancies are on the rise, residential property prices have risen noticeably over the past year. The ABSA property survey shows that residential property prices have risen by an average of almost 15% in the past year. In addition, residential mortgage financing activity has improved marginally in the past few months, albeit off a low base in the early part of 2009.

## United States

### US Retail Sales

- US headline retail sales rose by a slightly more encouraging 0.4%*m/m*, after two months of decline. US retail sales are still, effectively, struggling to gain any meaningful traction; but not necessarily slipping back into recession.
- If motor sales are excluded, retail sales rose by a more modest 0.2%*m/m*. If vehicle sales and petrol sales are excluded (which is appropriate since sales are reported in nominal terms) retail sales were actually down by 0.1%*m/m*.
- On an annual basis, US retail sales are up 5.5%*y/y* (in nominal terms), which is still relatively healthy, but well below the peak of 8.7%*y/y* in April 2010. Importantly, excluding vehicles and gasoline, sales are up a modest 4.0%*y/y*, which is well below the average from 2004 to 2007 of 5.5%.

### US Housing Starts

- US housing starts rose by a modest 1.7%*m/m* to 546 000.
- Housing starts reached a record low of 477 000 in April 2009, and have since increased by a total of 14.5%. Despite the increase, the overall level of housing construction is still dramatically below the 2006 peak level of over 2.2 million. It will probably take the housing market many years to re-gain the previous peak.
- Unfortunately, housing permits fell more than expected in July, down 3.1%*m/m* to 565 000. The market was expecting a decline of 0.5%*m/m*. There is a reasonably close relationship between the growth in building permits and housing starts, which would suggest no real improvement in housing activity in the months ahead. Overall, building permits remain extremely depressed and close to the record low of 522 000 in March 2009.

### US Leading Economic Indicators

- US leading economic indicator rose by a very modest 0.1%*m/m*. The June reading was revised down from an initial decrease of 0.2%*m/m* to 0.3%*m/m*.
- Over the past year, the leading index is still up 7.1%*y/y* BUT, importantly, the momentum has clearly slowed and the annual rate of change is well below the peak of 11.6%*y/y* recorded as recently as March 2010. Furthermore, the leading indicator is likely to trend lower on an annual basis over the next few months.

- The leading indicator is comprised of ten components. During the month only 5 of the 10 components that make up the index rose, while 5 fell or remained unchanged. Consumer expectations, building permits, money supply, and stock prices made the largest negative contributions to the index. These declines were mainly offset by a rise in the interest rate spread (yield curve).

**Kevin Lings and Laura Jones**  
(STANLIB Economics)

# Weekly Market Analysis

Currencies/ indices/ commodities	Friday's Close 20/08/10	Weekly Move (%)	YTD (%)
<b>Indices</b>			
*MSCI World - US Dollar	1093.76	-0.89	-6.39
*MSCI World - Rand	8018.88	-0.81	-7.42
*MSCI Emerging Market - US Dollar	988.16	0.78	-0.13
*MSCI Emerging Market - Rand	7244.59	0.86	-1.23
All Share Index - US Dollar	3694.17	-2.04	-1.20
All Share Index - Rand	26989.63	-1.95	-2.45
All Bond Index	339.01	1.90	13.35
Listed Property J253	795.63	0.02	18.56
<b>Currencies</b>			
US Dollar/Rand	7.31	0.10	-0.47
Euro/Rand	9.29	-0.21	-11.54
Sterling/Rand	11.35	-0.20	-4.49
Euro/US Dollar	1.27	-0.34	-11.68
<b>Commodities</b>			
Oil Brent Crude Spot Price (\$/bl)	73.45	-1.96	-4.86
Gold Price \$/oz	1227.90	1.02	11.95
Platinum Price S/oz	1509.50	0.85	2.72

Source: I-Net Bridge

\* MSCI - Morgan Stanley Capital International

# Rates

These rates are expressed in nominal and effective terms and should be used for indication purposes ONLY.

## Standard Bank Money Market Fund

Nominal: 6.85% per annum

Effective: 7.07% per annum

STANLIB is required to quote an effective rate which is based upon a seven-day rolling average yield for Money Market Portfolios. The above quoted yield is calculated using an annualised seven-day rolling average as at 20 August 2010. This seven-day rolling average yield may marginally differ from the actual daily distribution and should not be used for interest calculation purposes. We however, are most happy to supply you with the daily distribution rate on request, one day in arrears. The price of each participatory interest (unit) is aimed at a constant value. The total return to the investor is primarily made up of interest received but, may also include any gain or loss made on any particular instrument. In most cases this will merely have the effect of increasing or decreasing the daily yield, but in an extreme case it can have the effect of reducing the capital value of the portfolio.

## STANLIB Cash Plus Fund

Effective Yield: 7.22%

## STANLIB Dividend Income Fund

Effective Yield: 4.75%

STANLIB is required to quote a current yield for Income Portfolios. This is an effective yield. The above quoted yield will vary from day to day and is a current yield as at 20 August 2010. The net (after fees) yield on the portfolio will be published daily in the major newspapers together with the "all-in" NAV price (includes the accrual for dividends and interest). This yield is a snapshot yield that reflects the weighted average running yield of all the underlying holdings of the portfolio. Monthly distributions will consist of dividends (currently tax exempt) and taxable interest. Interest will also be exempt from tax to the extent that investor's are able to make use of the applicable interest exemption as currently allowed by the Income Tax Act. The portfolio's underlying investments will determine the split between dividends and interest.

The Manager has received a circular, (CISCA Circular No.11), from the Registrar of Collective Investment Schemes regarding a joint investigation of National Treasury, SARS and the FSB, which is currently in progress with regard to dividend income fund type portfolios. The Manager is obliged, in terms of this circular, to bring the following to your attention with regard to this investigation. The outcome of the investigation could affect certain structures and SPVs (special purpose vehicles) used by underlying investments of these types of portfolios, which may result in possible adverse tax consequences, and may require amendments to existing legislation. The abovementioned regulators still have concerns which could impact negatively on the future of these portfolios and the continuation of these portfolios can therefore not be guaranteed. The Manager however do not believe that there is any current cause for concern regarding the STANLIB Dividend Income Fund and should there be a more definitive outcome from the investigation investors in our STANLIB Dividend Income Fund will be informed timeously of any legislative changes that may affect their investment.

## Liberty Investments' Life Annuities

### Current Rates for 23<sup>rd</sup> August - 27<sup>th</sup> August 2010

Payments are assumed to be paid monthly in advance with no guarantee period or annual escalation in income. Ages indicated assume client is the exact age shown. No tax has been deducted.							
Gender		Male			Female		
Age last birthday		55	60	65	55	60	65
Contribution	R 100,000	R 739	R 803	R 884	R 668	R 712	R 775
	R 250,000	R 1,868	R 2,029	R 2,234	R 1,690	R 1,802	R 1,959
	R 500,000	R 3,751	R 4,074	R 4,484	R 3,394	R 3,619	R 3,932
	R 1,000,000	R 7,516	R 8,162	R 8,983	R 6,801	R 7,252	R 7,879

The table above shows the monthly annuity that an annuitant will receive for life in return for the single premium in the left hand column. Note that the annuity depends on the annuitant's exact age and gender.

The rates above were calculated assuming maximum commission and will be enhanced if a commission discount is selected.

# Glossary of terminology

<b>Bonds</b>	A bond is an interest-bearing debt instrument, traditionally issued by governments as part of their budget funding sources, and now also issued by local authorities (municipalities), parastatals (Eskom) and companies. Bonds issued by the central government are often called "gilts". Bond issuers pay interest (called the "coupon") to the bondholder every 6 months. The price/value of a bond has an inverse relationship to the prevailing interest rate, so if the interest rate goes up, the value goes down, and vice versa. Bonds/gilts generally have a lower risk than shares because the holder of a gilt has the security of knowing that the gilt will be repaid in full by government or semi-government authorities at a specific time in the future. An investment in this type of asset should be viewed with a 3 to 6 year horizon.
<b>Cash</b>	An investment in cash usually refers to a savings or fixed-deposit account with a bank, or to a money market investment. Cash is generally regarded as the safest investment. Whilst it is theoretically possible to make a capital loss investing in cash, it is highly unlikely. An investment in this type of asset should be viewed with a 1 to 3 year horizon.
<b>Collective Investments</b>	Collective investments are investments in which investors' funds are pooled and managed by professional managers. Investing in shares has traditionally yielded unrivalled returns, offering investors the opportunity to build real wealth. Yet, the large amounts of money required to purchase these shares is often out of reach of smaller investors. The pooling of investors' funds makes collective investments the ideal option, providing cost effective access to the world's stock markets. This is why investing in collective investments has become so popular the world over and is considered a sound financial move by most investors.
<b>Compound Interest</b>	Compound interest refers to the interest earned on interest that was earned earlier and credited to the capital amount. For example, if you deposit R1 000 in a bank account at 10% and interest is calculated annually, your balance will be R1 100 at the end of the first year and R1 210 at the end of the second year. That extra R10, which was earned on the interest from the first year, is the result of compound interest ("interest on interest"). Interest can also be compounded on a monthly, quarterly, half-yearly or other basis.
<b>Dividend Yields</b>	The dividend yield is a financial ratio that shows how much a company pays out in dividends each year relative to its share price. The higher the yield, the more money you will get back on your investment.
<b>Dividends</b>	When you buy equities offered by a company, you are effectively buying a portion of the company. Dividends are an investor's share of a company's profits, given to him or her as a part-owner of the company.
<b>Earnings per share</b>	Earnings per share is a measure of how much money the company has available for distribution to shareholders. A company's earnings per share is a good indication of its profitability and is generally considered to be the most important variable in determining a company's share price.
<b>Equity</b>	A share represents an institution/individual's ownership in a listed company and is the vehicle through which they are able to "share" in the profits made by that company. As the company grows, and the expectation of improved profits increases, the market price of the share will increase and this translates into a capital gain for the shareholder. Similarly, negative sentiment about the company will result in the share price falling. Shares/equities are usually considered to have the potential for the highest return of all the investment classes, but with a higher level of risk i.e. share investments have the most volatile returns over the short term. An investment in this type of asset should be viewed with a 7 to 10 year horizon.

<b>Financial Markets</b>	Financial markets are the institutional arrangements and conventions that exist for the issue and trading of financial instruments.
<b>Fixed Interest Funds</b>	Fixed interest funds invest in bonds, fixed-interest and money market instruments. Interest income is a feature of these funds and, in general, capital should remain stable.
<b>Gross Domestic Product (GDP)</b>	The Gross Domestic Product measures the total volume of goods and services produced in the economy. Therefore, the percentage change in the GDP from year to year reflects the country's annual economic growth rate.
<b>Growth Funds</b>	Growth funds seek maximum capital appreciation by investing in rapidly growing companies across all sectors of the JSE. Growth companies are those whose profits are in a strong upward trend, or are expected to grow strongly, and which normally trade at a higher-than-average price/earnings ratio.
<b>Industrial Funds</b>	Industrial funds invest in selected industrial companies listed on the JSE, but excluding all companies listed in the resources and financial economic groups.
<b>Investment Portfolio</b>	An investment portfolio is a collection of securities owned by an individual or institution (such as a collective investment scheme). A funds ' portfolio may include a combination of financial instruments such as bonds, equities, money market securities, etc. The theory is that the investments should be spread over a range of options in order to diversify and spread risk.
<b>JSE Securities Exchange</b>	The primary role of the JSE Securities Exchange is to provide a market where securities can be freely traded under regulated procedures.
<b>Price to earnings ratio</b>	Price to earnings ratio or p:e ratio, is calculated by dividing the price per share by the earnings per share. This ratio provides a better indication of the value of a share, than the market price alone. For example, all things being equal, a R10 share with a P/E of 75 is much more "expensive" than a R100 share with a P/E of 20.
<b>Property</b>	Property has some attributes of shares and some attributes of bonds. Property yields are normally stable and predictable because they comprise many contractual leases. These leases generate rental income that is passed through to investors. Property share prices however fluctuate with supply and demand and are counter cyclical to the interest rate cycle. Property is an excellent inflation hedge as rentals escalate with inflation, ensuring distribution growth, and property values escalate with inflation ensuring net asset value growth. This ensures real returns over the long term.
<b>Resources and Basic Industries Funds</b>	These funds seek capital appreciation by investing in the shares of companies whose main business operations involve the exploration, mining, distribution and processing of metals, minerals, energy, chemicals, forestry and other natural resources, or where at least 50 percent of their earnings are derived from such business activities, and excludes service providers to these companies.
<b>Smaller Companies Funds</b>	Smaller Companies Funds seek maximum capital appreciation by investing in both established smaller companies and emerging companies. At least 75 percent of the fund must be invested in small- to mid-cap shares which fall outside of the top 40 JSE-listed companies by market capitalisation.
<b>Value Funds</b>	These funds aim to deliver medium- to long-term capital appreciation by investing in value shares with low price/earnings ratios and shares which trade at a discount to their net asset value.

*Sources: Unit Trust and Collective Investments (September 2007), The Financial Sector Charter Council, Personal Finance (30 November 2002), Introduction to Financial Markets, Personal Finance, Quarter 4 2007, Investopedia ([www.investopedia.com](http://www.investopedia.com)) and The South African Financial Planning Handbook 2004.*

# Disclaimer

The price of each unit of a domestic money market portfolio is aimed at a constant value. The total return to the investor is primarily made up of interest received but, may also include any gain or loss made on any particular instrument. In most cases this will merely have the effect of increasing or decreasing the daily yield, but in an extreme case it can have the effect of reducing the capital value of the portfolio. Collective Investment Schemes in Securities (CIS) are generally medium to long term investments. The value of participatory interests may go down as well as up and past performance is not necessarily a guide to the future. An investment in the participations of a CIS in securities is not the same as a deposit with a banking institution. CIS are traded at ruling prices and can engage in borrowing and scrip lending. A schedule of fees and charges and maximum commissions is available on request from STANLIB Collective Investments Ltd (the Manager). Commission and incentives may be paid and if so, would be included in the overall costs. Forward pricing is used. TER is the annualised percent of the average Net Asset Value of the portfolio incurred as charges, levies and fees. A higher TER ratio does not necessarily imply a poor return, nor does a low TER imply a good return. The current TER cannot be regarded as an indication of future TERs. Portfolios are valued on a daily basis at 15h30. Investments and repurchases will receive the price of the same day if received prior to 15h30. Liberty is a full member of the Association for Savings and Investments of South Africa. The Manager is a member of the Liberty Group of Companies.

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